

Los Alamos National Laboratory

**External Review of The Purchase Card Program
Report of Findings**

December 12, 2002

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Dr. John C. Browne
Director, Los Alamos National Laboratory
Los Alamos National Laboratory
Los Alamos, NM 87545

Subject: Report of Findings re: External Review of The Purchase Card Program

The External Review Team has completed an administrative review of the Los Alamos National Laboratory (LANL) Purchase Card Program and the Report of Findings is attached. I was assisted in this review by Mr. Charles C. Masten, Vice Chair, along with a team of forensic accountants from PricewaterhouseCoopers.

We reviewed documentation and data for the period October 1, 1998 through June 30, 2002 and conducted interviews of cardholders, requesters, approvers and managers. Several areas have been identified for improvement in the management and application of the Purchase Card Program. We have concluded that internal control weaknesses existed in the program, which left LANL vulnerable to fraud and abuse. Numerous cardholders failed to reconcile monthly purchase card statements and managers did not ensure that these statements were appropriately reviewed. Purchases were made in violation of LANL policies and procedures. Disputed items were neither credited by the bank nor followed-up by the cardholders in numerous instances. We provided your management team with lists of transactions requiring additional explanation and for the purpose of determining the appropriateness of specific costs.

The corrective actions recently announced by LANL, along with implementation of the recommendations contained in the attached Report of Findings should provide for an enhanced control environment for the Purchase Card Program. Further, we recommend periodic follow-up on these corrective actions.

If you should have any questions regarding our administrative review or the Report of Findings, please do not hesitate to contact me.

Sincerely,



John C. Layton
Chair, External Review Committee

Attachment

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**Los Alamos National Laboratory
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Report of Findings**

I. Overview

We were retained by the Director's Office of Los Alamos National Laboratory (LANL) to conduct an independent administrative review of the LANL Purchase Card Program (the "Program"). Specifically, we were tasked to:

- Evaluate current policies and procedures;
- Evaluate current practices;
- Identify control weaknesses or vulnerabilities;
- Investigate suspect or abnormal purchase transactions, trends or patterns;
- Provide relevant observations and conclusions; and
- Recommend corrective actions for strengthening the Program.

The focus of our review was the 45-month period beginning October 1, 1998 and ending June 30, 2002 (the "Review Period"). In conjunction with this review, we were asked to further analyze the purchase card procurement activity of a particular LANL buyer.

A. Review Team Organization

The External Review Team (the "Review Team") is comprised of two External Review Committee members, Mr. John C. Layton and Mr. Charles C. Masten, assisted by a forensic accounting team, lead by Mr. Donald J. Kintzer, from the University of California's audit firm, PricewaterhouseCoopers (PwC). The Review Team's fieldwork was initiated on August 26, 2002 and concluded on November 8, 2002.

B. Background

The LANL Pilot Credit Card Procurement Program was founded in February 1993. The LANL Purchase Card Program was fully implemented by December 1994 and was conceived as a component of the Total Integrated Procurement System (TIPS) to streamline procurement activities and reduce costs.

Purchase cards are credit cards issued to LANL employees for the procurement of low-value goods and services. LANL purchase cards are currently issued by BankOne and bear the MasterCard logo. LANL cardholders include procurement specialists (buyers), whose primary job responsibility is to procure goods and services on behalf of LANL, as well as administrative, managerial and technical personnel.

All cardholders are permitted to procure items for themselves or for others, referred to as requestors. Cardholders are required to enter purchase card purchases in an on-line system called the LANL Purchase Card System. At month end, cardholders electronically reconcile their detailed procurement activity with statements provided by the bank. The Purchase Card Program is not a reimbursement-based program; LANL pays directly for cardholder purchases and cardholders are required to verify purchases and reconcile their credit card statements.

The Purchase Card Program is managed by the LANL Procurement group, part of the Business Operations (BUS) division. A Purchase Card Administrator, reporting to the Team Leader of Streamlined Procurements, is responsible for day-to-day operations of the Program. The Administrator's job responsibilities include developing and conducting training, planning and supervising quarterly audits and reviews, interacting with BankOne and responding to cardholder inquiries. Since inception, there have been five Program Administrators with the current administrator in place since August 2001. Currently, the Purchase Card Office is staffed with five full-time employees.

According to a former Purchase Card Administrator, there was a reduction in force at LANL in 1996. The Purchase Card Program was viewed as a cost-saving mechanism by which work could be transferred from buyers to technical requestors, thereby allowing LANL to reduce the size of its procurement staff. As a result, LANL management placed strong emphasis on the Purchase Card Program and encouraged cardholders to make small procurements themselves instead of seeking the assistance of a buyer. Simultaneously, management encouraged buyers to increase their utilization of purchase cards. To this end, all buyers were required to become cardholders and were granted limits of \$25,000 per transaction or more. In addition, buyers were permitted to self-approve purchase card transactions. According to a former Purchase Card Administrator, the rationale behind higher limits and self-approval rights for buyers was that these individuals, as procurement specialists, are authorized by their signing authority to make purchases of up to \$100,000 or more without additional approval.

1. Use of Purchase Cards at LANL

Total purchases made with the purchase card during the Review Period amounted to \$120 million for approximately 170,907 separate transactions¹, an average of approximately \$700 per transaction. The use of LANL purchase cards has remained relatively constant since fiscal 1999. However, the average transaction has increased from \$661 in fiscal 1999 to \$766 in fiscal 2002. The following is a summary of purchase card activity during the Review Period:

¹ A distinct reference number defines a transaction.

TABLE 1: Summary of Purchase Card Activity²

Fiscal Year	Active Cardholders	Amount Procured	Number of Transactions	Average Transaction
1999	887	\$32,322,507	48,881	\$661
2000	874	27,547,563	41,321	667
2001	881	34,243,084	46,492	737
2002	799	35,814,065	46,773	766

Of the total amount purchased during the Review Period, buyers were responsible for over \$40.8 million (approximately 34%) of total purchase card procurements.³ Buyers' spending limits were significantly higher than non-buyer cardholders (generally \$25,000 per transaction), although these higher limits were not documented in LANL's policies and procedures. The dollar value of purchases made by buyers' were, on average, 68% greater than the purchases of non-buyer cardholders (\$1,661 per transaction for buyers compared to \$534 for other cardholders). Until August 26, 2002, buyers were permitted to self-approve their purchase card statements (i.e., no review by a supervisor or other third party was required).

We determined that the Engineering Sciences and Applications, Nonproliferation and International Security divisions as well as Johnson Controls Northern New Mexico were the major requestors of items purchased using LANL purchase cards during our Review Period (see Table 2).

² FY02 data provided by LANL Purchase Card Office. Data for July through September 2002 was not available when the External Review commenced and was therefore not reviewed by the External Review Team but is included in the FY02 data provided above.

³ Due to personnel turnover and lack of historical data, we were unable to associate \$11.8 million of purchases with a specific group.

TABLE 2: Top Five Divisions Using Purchase Cards

Title	Division	Amount Procured	Number of Transactions	Average Transaction
ESA	Engineering Sciences and Applications	\$18,928,568	12,925	\$1,464
JCNNM	Johnson Controls Northern New Mexico	9,980,832	23,754	420
NIS	Nonproliferation and International Security	8,922,490	12,662	705
MST	Materials Science and Technology	7,391,686	9,767	757
DX	Dynamic Experimentation	7,387,834	8050	918

The majority of cardholders contributed to 2% or less of total purchase card purchases. However, one cardholder was responsible for 13% of total purchase card procurements during the Review Period. Together, the top five cardholders were responsible for 22% of all purchase card activity (see Table 3).

TABLE 3: Top Five Cardholders Purchasing with the Purchase Card

Cardholder	Number of Items	Amount Procured	% Of Total Purchases
Cardholder A	11,462	\$15,078,110	13%
Cardholder B	2,215	3,273,688	3%
Cardholder C	2,572	2,386,550	2%
Cardholder D	2,504	2,308,982	2%
Cardholder E	951	2,177,448	2%

In contrast, no single requestor was responsible for more than 2% of total purchase card activity (see Table 4).

TABLE 4: Top Five Requestors of Purchase Card Purchases

Requestor	Number of Items	Amount Procured	% Of Total Purchases
Requestor A	4,063	\$2,671,470	2%
Requestor B	3,068	1,829,874	2%
Requestor C	4,415	911,070	1%
Requestor D	4,868	875,071	1%
Requestor E	410	860,478	1%

2. Summary of Prior Audit Findings

In fiscal 1996, LANL's Audits and Assessments division conducted a review of the LANL Purchase Card Procurement Program. A follow-up audit of the Purchase Card Program was conducted in fiscal 1997. Both audits were designed to identify internal control weaknesses. The findings of these reviews are summarized below:

TABLE 5: Summary of Prior Audit Findings

Finding	FY96	FY97
Purchase of Restricted Item		X
Improper Source/Vendor		X
Insufficient Documentation/ Description	X	X
Unauthorized Users/ Safeguarding Card Information	X	X
Inadequate Reconciliation Procedures		X
Inadequate Approval Procedures		X
Insufficient Proof of Delivery/Receipt		X
Failure to Properly Record Fixed Assets	X	X
Failure to Properly Account for Purchases	X	X
Failure to Utilize Enhanced Reporting Capabilities		X
Duplicate Payments on Purchase Orders	X	
Failure to Track Resolution of Disputed Purchases	X	
Failure to Ensure Funds are Budgeted	X	

The above findings are similar to those reported by the General Accounting Office regarding reviews of the Departments of the Army and Navy purchase card programs. The Department of Energy also reported similar findings in report dated February 2, 2002, which summarized findings from twenty purchase card reviews conducted since 1998.

3. Mustang Transaction

On July 18, 2002, Bank of America (LANL's then purchase card provider) notified the Purchase Card Administrator that an automobile was charged to a LANL purchase card. The Administrator was further informed that the cardholder disputed the charges and that Bank of America reversed the charges.⁴

4. Other Activities

Subsequent to notification of the above transaction, LANL commenced an internal review of the Purchase Card Program and assessed programmatic control weaknesses. The internal review team identified a number of control vulnerabilities and proposed corrective actions. Based in part on these findings, LANL took the following actions:

- Announced modifications and changes to the Purchase Card Program, to be effective August 26, 2002; and
- Retained this External Review Team to conduct an independent review of the Program.

C. Summary of Findings

LANL's Purchase Card Program was established as an instrument for expediting procurement. We observed programmatic control weaknesses, which we believe made LANL vulnerable to fraud and/or abuse. LANL took steps to improve the internal control environment on August 26, 2002, when a series of initiatives designed to improve the internal controls of the Purchase Card Program were announced.

As a result of our review procedures, we made a number of observations regarding the LANL Purchase Card Program. For each observation, we considered the appropriateness of corrective actions announced on August 26, 2002 and if necessary, formulated recommendations for further corrective action.⁵

1. Program Observations

We observed a number of programmatic weaknesses, including:

- Extensive use of purchase cards by procurement specialists (buyers) without programmatic modifications;
- Failure to reconcile and approve monthly statements;

⁴ The Cardholder is presently on administrative (investigative) leave.

⁵ Because the Review Period concluded on June 30, 2002, we did not test implementation of the August 26, 2002 corrective actions.

- Failure to resolve disputed transactions;
- Failure to properly account for controlled property;
- Purchase of restricted items in violation of LANL policies;⁶
- Insufficient documentation of items purchased;
- Inadequate or ineffective sanctions for non-compliance;
- Insufficient training, especially for approvers;
- Insufficient program audit and review procedures;
- Failure to properly manage cardholder spending limits; and
- Failure to safeguard card information.

2. Matters Referred to Appropriate Authorities

In connection with our procedures, we reviewed several inappropriate transactions. The following transactions, some of which were identified by LANL prior to our review, have been referred to the appropriate authorities.⁷

- Mustang Transaction;
- Casino cash advances;
- Retail department store charges; and
- Jewelry purchase.

The potential loss to LANL stemming from these transactions is presently estimated at approximately \$2,800.

3. Corrective Actions

On August 26, 2002, LANL management announced changes in the Purchase Card Program, which we believe substantially address many of the observed control weaknesses. Nonetheless, during the course of our review we identified additional areas for improvement. Therefore, in addition to the above changes, we recommend the following additional corrective actions:

- Require approvers to take a more active role in the compliance process by notifying them of violations (including failure to reconcile) and requiring approvers to ensure resolution;

⁶ Restricted items include products available through the Just In Time system, unallowable expenditures including items that do not meet the test of business necessity, and other purchases not authorized for procurement on a LANL purchase card.

⁷ Recent press articles suggest that two LANL employees illegally used Purchase Cards to procure \$50,000 in unauthorized merchandise including gas grills, hunting knives and camping equipment. Although both are cardholders, the alleged purchases were not made on LANL purchase cards and were, therefore, not within the scope of this review.

- Follow-up on all unreconciled accounts and implement sanctions for cardholders who fail to reconcile on a timely basis;
- Establish policies and procedures governing the use of purchase cards by buyers;
- Implement sanctions for inappropriate card usage; and
- Perform routine data mining to diagnose trends and to identify possible improper or fraudulent transactions.

II. Procedures Performed

In conducting our review of the LANL Purchase Card Program, we reviewed policies and procedures in existence during the Review Period. We also conducted interviews of LANL personnel and analyzed purchase card data and supporting documentation for selected transactions. This approach was designed to provide perspective on the intended uses of the Program as well as the ways in which the Program is actually used in practice. Further details on the procedures we performed are outlined below.

A. Review of Policies and Procedures

We obtained the policies and procedures governing the Purchase Card Program in effect immediately prior to the changes adopted on August 26, 2002. Through inquiries and interviews with former Purchase Card Administrators and cardholders, we obtained prior versions of the policies and procedures from 1998, 1999 and early 2002. These earlier versions of the purchase card policies and procedures allowed us to obtain an understanding and perspective of the policies and procedures during the Review Period. The policies and procedures generally address the following areas:

- General purchasing guidelines including unauthorized purchases;
- Cardholder and approving official responsibilities;
- How to enter information in the electronic Purchase Card System;
- Documentation and reconciliation procedures;
- General shipping guidelines;
- Procedures for processing disputes; and
- Procedures for reporting lost or stolen purchase cards.

Other than periodic updates to the unauthorized items list, there have been five significant changes to the policies and procedures from 1998 until the changes adopted on August 26, 2002. These changes include:

- Addition of language allowing the \$2,500 single transaction purchasing limit to be increased after the cardholder has established a sustained record of purchasing;

- Change in documentation retention from 3 years to 6 years;
- Changes to requirements regarding who should maintain records when a cardholder transfers groups;
- Revision of the sensitive items list⁹; and
- Addition of a new requirement that cardholders document the reason for not purchasing through JIT.¹⁰

A number of significant changes were recently made to the policies and procedures. These changes were made in response to an internal review of the Purchase Card Program, following the discovery of the Mustang Transaction in July 2002. The following are highlights of the more recent changes:

- Implemented refresher training for all cardholders and required approvers to attend Purchase Card Program training;
- Established 5:1 maximum ratio of cardholders to approver;
- Prohibited cardholders from approving their own purchase card statements;
- Changed approving officials (responsible for approving reconciled purchase card statements) from group to team leader;
- Decreased cardholder spending limits to \$2,500 per transaction and \$25,000 per month. Limit may be increased to a maximum of \$5,000 and \$50,000 per month when justified and with written approval of the Division Leader;
- Prohibited the purchase of property-controlled items (including sensitive items such as VCR's and palm pilots) without authorization by Property Manager;
- Permitted cardholders to delegate their statement reconciliation responsibility only when on leave of absence (reconciliation may not be delegated to the cardholder's approving official);
- Prohibited cardholders from providing purchase card number to requestors;
- Notified cardholders that purchase cards may be suspended if the purchase card statement is not reconciled within two statement cycles;
- Required all over-the-counter purchases greater than \$500 must be processed by the approving official;

⁹ Removed the following items from the list: electronic balances, bicycles, external CD ROM drives, fax machines, microwave ovens, typewriters and televisions

¹⁰ Just-in-time subcontractors are pre-established LANL vendors for selected high-volume, low-value items.

- Required all phone and internet orders be shipped to the LANL warehouse (exceptions require written approval by the cardholder's division leader); and
- Prohibited cardholders from shipping items directly to themselves (exceptions require written approval from the cardholder's division leader).

B. Interviews

We conducted 41 interviews of 36 individual employees including LANL management, cardholders, requestors and approvers. The purpose of our interviews was as follows:

- Obtain an understanding of actual purchase card practices;
- Assess cardholder, requestor and approvers' familiarity with Purchase Card Program policies and procedures; and
- Request information on specific targeted transactions.

Based on an agreement between the Federal Bureau of Investigation and LANL management, the Review Team did not interview three LANL employees whose insights may have been relevant to our findings. In addition, based upon a similar understanding, we did not interview individuals outside of the LANL facility.

C. Analytical Review

We obtained and analyzed electronic purchase card data for the Review Period. To gain an understanding of how purchase cards were used in practice during the Review Period, we performed three separate procedures. First, we performed data mining procedures, including key word searches and criteria queries (i.e., no description, not reconciled, etc.), on the complete population of purchases. Second, we selected a random sample of purchases and requested supporting documentation. Finally, based on the results of our data mining procedures and analyses, we targeted a selection of purchases and requested supporting documentation.

1. Data Mining

Data mining is a process by which historical data is extracted and analyzed to obtain an understanding of trends, patterns and other relevant information. During our data mining procedures, we specifically:

- Tested the completeness of purchase card data by reconciling electronic purchase card totals to a summary statement provided by the banks issuing LANL purchase cards;
- Developed a list of risk factors based on the results of prior Purchase Card Program audits as well as LANL policies and procedures for the Purchase Card Program;

- Queried the purchase card data for occurrences of these risk factors in the population; and
- Compiled the results of these queries.

Through review of prior audits and policies and procedures, we developed a refined list of factors to apply in our analysis of the purchase card data. These risk factors and an explanation for each are listed in Table 6 below:

TABLE 6: Data Mining Risk Factors

Risk Factor	Explanation
Purchases for Potential Personal Use	Item description suggests item could be for personal item and/ or vendor is likely to sell items for personal use items
Unauthorized or Unallowable Costs	Items included on the Unauthorized ¹¹ or Unallowable ¹² Lists
Split Transactions	Vendor divided purchase into two or more transactions, possibly to avoid cardholder single transaction limits
Self Approved	Cardholder is also approver of own purchases
Not Approved	Purchase card reconciliation was not approved electronically within required number of days ¹³
Not Reconciled	Cardholder did not complete purchase card reconciliation electronically within required number of days
No Description	Cardholder did not enter a description of the item that was purchased
Potential Improper Source/Vendor	Cardholder purchased an item that was available through JIT from a non-JIT vendor

¹¹ List is included in the Purchase Card Program policies and procedures. These items cannot be purchased using the purchase card as the procurement method.

¹² Sourced from LANL Procurement Standard Practices Section 31, Subject 31.3 Unallowable Costs. These items are unallowable under LANL's Prime Contract.

¹³ Approver may have submitted approval manually. The Purchase Card Office did not track manual reconciliations electronically.

TABLE 6: Data Mining Risk Factors (Continued)

Risk Factor	Explanation
Charge Exceeds Cardholder's Transaction or Monthly Limit	Purchase exceeds cardholder's approved single transaction or monthly purchasing limit
Property Controlled Item	Equipment with an initial acquisition or fabrication cost of \$5,000 or greater or a sensitive item ¹⁴

2. Random Sample Selection

A random sample of 300 purchase card items was selected for testing from items procured during the Review Period. The sampled items represent purchases from 177 different cardholders. Documentation supporting the selected purchases was requested directly from the cardholders.

The criteria we used to assess this random sample were designed to test the accuracy of data entered into the purchase card system by the cardholders and to test cardholder compliance with established policies and procedures. Our review assessed compliance with LANL policies and procedures including:

- Was the purchase card statement reconciled within 21 days;
- Is the requestor properly identified;
- Was appropriate documentation maintained;
- If the item was disputed, was the dispute properly resolved;
- Is the item available through JIT;
- If the item is shipped to an off-site location, is there a signature of someone other than the cardholder verifying receipt of item; and
- Does the charge meet the test of business necessity?

3. Targeted Sample Selection

We selected four targeted samples from the remaining population of purchase card data. These samples were specifically designed to include items most at risk of being non-compliant with LANL policies and procedures.

First, a targeted sample was judgmentally selected based on our data mining procedures and includes 205 items. To select this sample, we prepared a listing of all items flagged through our data mining procedures with three or more risk factors. We then reviewed this list and judgmentally selected items that appeared unusual or non-compliant.

¹⁴ The sensitive item list has changed slightly over the review period. As of 10/02, the sensitive item list was comprised of: cameras, firearms, personal computers, printers, recorders, scanners & telephones.

Finally, we performed a cursory review of items flagged with three or fewer risk factors and added several of these items to the targeted sample.

Second, a sample consisting of disputed items¹⁵ not credited as of June 30, 2002 was selected. Of the 513 disputed items that do not appear to have been credited, 45 items were selected for review.

Third, a sample was selected from the purchase card activity of a targeted cardholder and a targeted requestor and consisted of 100 items.

Fourth, a sample consisting of property-controlled items and items attractive for personal use was selected. Of the 86 items in this sample, 34 items are also included in the previously selected samples. For the items in this sample, the Review Team and LANL property management personnel jointly performed physical observations of the items and determined if property-controlled items were bar-coded.

III. Findings, Observations and Corrective Actions

Based on the procedures described above, including the review of policies and procedures, interviews, and analysis of specific transactions, we formulated a number of observations with respect to the LANL Purchase Card Program. For each of the identified observations, we considered LANL's recent corrective actions to determine if the changes were sufficient to rectify the observed issue. In addition, during the course of our review, we identified improper transactions, which we understand LANL has referred to the appropriate authorities.

A. Program Observations

1. Use of Purchase Cards by Buyers

a. Observation

Approximately 8% of cardholders are procurement specialists (buyers) who use purchase cards to fulfill purchase requests that would otherwise be placed on purchase orders. Because buyers have procurement authority averaging more than \$25,000 per transaction, they were granted higher spending limits than ordinary cardholders. Furthermore, since buyers do not require approval for purchases within their procurement authority, they were permitted to self-approve their purchase card statements.

In most cases, buyers purchase on behalf of others, although some buyers also purchased items for themselves. We found that approximately 10% of procurements made by buyers did not involve a separate requestor. This, in combination with high spending limits and the lack of third-party approvers for buyers, created an environment conducive to misuse.

¹⁵ During data entry of a purchase, a cardholder can click on a "dispute" button that automatically enters the word "dispute" in the description text field. The cardholder is responsible for then submitting a dispute form, explaining the dispute, to the bank.

During our review period, we noted that the policies and procedures as written did not address this large contingent of cardholders. As a result, in many respects, buyers operated outside the parameters of the written policies and procedures.

b. Corrective Actions Taken

Revisions to policies and procedures effective August 26, 2002 attempt to bring buyers' use of purchase cards back in line with existing policies and procedures. Currently, single transaction limits are capped at \$2,500 for all cardholders and \$5,000 for cardholders with special approval. Self-approval of purchase card statements is now strictly prohibited.¹⁶

c. Recommendations for Further Corrective Action

We believe LANL's corrective actions to date will effectively minimize control deficiencies related to use of purchase cards by buyers. If LANL management determines that use of the purchase card as a procurement tool by buyers is desirable, we would recommend that LANL draft a Standard Practice to specifically address the use of purchase cards by buyers. The general policies and procedures should also be updated to reference the buyer guidance.

2. Reconciliation and Approval Procedures

a. Observation

The reconciliation and approval process is the most important internal control governing the Purchase Card Program. During the reconciliation process, cardholders are required to provide a detailed description of items purchased, the name of the requestor and the cost account to which the transaction should be charged. Once the reconciliation is complete, the statement is automatically forwarded to the cardholders' approver for on-line approval. Prior to 1999, approvers were required to review supporting documentation as part of the approval process. Since that time, approvers have only been required to perform "periodic" reviews of supporting documentation.

LANL's policies and procedures requires the cardholder, or individual who was delegated reconciling responsibility¹⁷, to reconcile the purchase card statement within 21 days of system notification. If a cardholder fails to reconcile within this timeframe, unreconciled charges were automatically posted to a designated overhead account, which could result in inappropriate or unallowable costs being inadvertently charged.¹⁸ The

¹⁶ An August 26, 2002 communication distributed to management and administrative support reinforced the existing policy that cardholders cannot approve their own monthly statements.

¹⁷ In past policy and procedure manuals, a cardholder could delegate this responsibility to another person in the cardholder's group. This provision has currently been revised to permit delegation of reconciliation only in a leave of absence situation.

reconciliation process provides information necessary to allow approvers and the Purchase Card Office to understand the nature of items purchased and also acts as a control mechanism for a cardholder to identify inappropriate or duplicate vendor charges.

We determined that approximately 7,000 items or \$3.8 million in purchases were not reconciled electronically within the allotted time. This correlates to approximately 1,600 statements that were not reconciled electronically during our review period. According to cardholders and former Purchase Card Administrators we interviewed, the Purchase Card Office actively sought manual reconciliations during much of the Review Period. The present Purchase Card Administrator, however, was unable to provide us with evidence of past manual reconciliations.

We determined that buyers were permitted to self approve their purchase card statements during the Review Period. Through our data mining procedures, we determined that more than \$43 million in purchases were subject to self-approval by the buyer cardholder and not by a group leader.¹⁹

We further determined that 45,000 items or \$16 million in purchases were not electronically approved within the allotted time frame. We believe many of these transactions were manually approved although we were unable to determine which statements were manually approved.

b. Corrective Actions Taken

Recent changes to the LANL Purchase Card Program policies and procedures added language stating that failure to reconcile within two statement cycles may result in suspension of the purchase card. The revised policies also prohibit buyers from self-approving purchase card activity. In addition, LANL implemented a cap on the number of cardholders assigned to a single approver (the maximum ratio is now five cardholders per approver). To facilitate these shifts in practice, LANL decreased the mandatory approval level from Group Leader to Team Leader. Finally, approvers are required to attend purchase card training. The training course, conducted by the Purchase Card Office, provides step-by-step reconciliation procedures and includes guidance on the responsibilities of the purchase card approving official.

c. Recommendations for Further Corrective Action

In addition to the above corrective actions, we recommend that LANL make a number of additional changes to the reconciliation and approval process. First, we recommend that approvers be required to review the actual support documentation compiled by the cardholder. Approval should be noted electronically as well as by signing the printed Statement of Account form. Second, we recommend that the Purchase Card Office track

¹⁸ According to the present Purchase Card Administrator, if a cardholder initiates a reconciliation, but does not complete the process and submit the statement for approval, the cost accounts identified by the cardholder will be charged (not the overhead account).

¹⁹ Many of the unreconciled statements were also not approved.

unreconciled or unapproved purchase card statements on a monthly basis and report these statistics to appropriate individuals within division management. Third, we recommend that LANL implement appropriate sanctions for cardholders who fail to comply with reconciliation procedures. Fourth, we recommend that manual reconciliations require the signature of the cardholder's group budget analyst before submission to the Purchase Card Office. The finance manager's signature indicates that charges posted to the default overhead account have been reversed and charged to the cost accounts designated by the cardholder. Finally, we recommend that LANL consider sanctions for approvers who fail to approve purchase card statements on a timely basis.

On November 21, 2002, the Review Team provided LANL management with a list of transactions totaling \$3.8 million that were not reconciled within 21 days according to the Purchase Card System. Management is currently researching these items to ensure that all items are properly reconciled, approved and charged to the appropriate cost account.

3. Dispute Resolution

a. Observation

In accordance with LANL's purchase card policy, cardholders are responsible for disputing duplicate, inaccurate or fraudulent charges and tracking these disputes to resolution. We determined that 513 charges made by 193 cardholders and totaling \$316,648 were disputed in the LANL Purchase Card System, but were never credited by the vendor or bank.

We selected a sample of 45 items (representing 21 cardholders) of the 513 disputed items and requested supporting documentation from the cardholder. We received and reviewed documentation for 29 of these items. Of the items reviewed, we found 10 items that were erroneously identified by the cardholder as a dispute and were, in fact, accurate charges. We identified 15 items for which credit was not issued because the cardholder failed to notify the bank of the dispute or failed to complete the necessary paperwork. The remaining items were partially credited or were credited in multiple installments.

According to present and former Purchase Card Administrators, the Purchase Card Office has never followed up on disputed items to determine if credit was issued. Because disputed charges were not tracked, inappropriate charges may have gone undetected.

b. Corrective Actions Taken

Our sample indicated that at least 3 cardholders do not understand or failed to properly execute the dispute process. This problem is being addressed in mandatory refresher training for all cardholders.

c. Recommendations for Further Corrective Action

We recommend that the LANL Purchase Card Office perform data mining procedures on a monthly basis to identify disputed items for which credit has not been issued. While

we believe that cardholders should retain the primary responsibility for ensuring that disputes are resolved, we further recommend that the Purchase Card Office take responsibility for monitoring disputes and following-up with cardholders. To ensure that disputed transactions are not overlooked, LANL should consider posting disputes to a suspense account managed by the Purchase Card Office rather than the cardholder's designated overhead account. In addition, we recommend that LANL consider appropriate actions concerning the purchase cards of cardholders who fail to resolve disputes on a timely basis.

In addition, cardholders should be trained on the proper procedures for disputing charges. We recommend that cardholders be trained to make one attempt to resolve the charge with the vendor. If this is not successful, the cardholder should dispute the charge directly with BankOne. All erroneous charges that cannot be easily resolved with the vendor should be disputed.

We noted that the current policy with respect to disputes is confusing and in some cases, misleading. For example, we noted that the dispute form available on the LANL intranet is for Nations Bank, a vendor LANL has not used for several years. As a result, we recommend that the policies and procedures regarding disputes be carefully reviewed and updated as necessary.

On December 2, 2002, we provided a listing of the 513 transactions noted above to LANL management for review and resolution.

4. Accounting for Property-Controlled Items

a. Observation

LANL policy requires items with a purchase or manufacture cost of \$5,000 or more as well as items deemed "sensitive" by LANL management be property-controlled. Property control procedures require the assignment of a barcode and property custodian to every controlled item. Custodians are required to account for all assets under their care by completing annual accountability statements. The Purchase Card Program policies and procedures required cardholders to notify the Property Manager once property-controlled items have been procured using a LANL purchase card.

We assessed cardholders' compliance with property-control policies and procedures by selecting a sample of 59 property-controlled items procured on LANL purchase cards. LANL's property management personnel were able to physically locate or account for 53 of these items. Of the 53 items accounted for, 31 were bar-coded in accordance with LANL policy (one additional item was returned to the vendor and therefore did not require a barcode). Of the remaining six items, one was allegedly at the residence of the property custodian, another was reported as lost or stolen, a third was believed to have been destroyed and the fourth was not located because the requestor is no longer employed by LANL and the remaining two have not been located. We also physically validated 27 additional items that were attractive for personal use but not subject to

property control. Of these items, we were able to physically observe or otherwise account for all 27 items.

It is the cardholder's responsibility to notify property management when a property-controlled item is procured using a purchase card. Furthermore, the property accounting group does not act upon a flag in the Purchase Card System, designed to notify accounting and/or property management that a property-controlled item was purchased.

According to a former Purchase Card Administrator, monthly desk reviews were once performed to identify property-controlled items procured on purchase cards that had not been bar-coded. According to the current Purchase Card Administrator, this procedure is no longer performed.

b. Corrective Actions Taken

Recent changes to the policies and procedures prohibit the procurement of property-controlled items unless advance authorization is obtained from the Property Manager. The policy also provides an electronic link to LANL's list of sensitive, property-controlled items.

c. Recommendations for Further Corrective Action

We concur with LANL management's decision to prohibit the procurement of property-controlled items using LANL purchase cards without prior approval. The revised policy does not, however, provide guidance regarding how to obtain authorization from the Property Manager or the procedures necessary to ensure that the asset receives a bar code. We recommend that LANL clarify this policy and ensure that the Property Manager is prepared to respond to cardholder's seeking exemptions from this policy.

We recommend that the LANL Purchase Card Office perform monthly data mining of purchase card data to identify possible procurements of property-controlled items. The Purchase Card Office should then refer these items to the cardholder for resolution. We further recommend that the approver be notified of the policy violation.

5. Purchase of Restricted Items

a. Observation

In performing our review, we identified a number of restricted items purchased on LANL purchase cards. Restricted items are those identified in the policies and procedures, which may not be procured using a LANL purchase card. Items are included on the list for a number of reasons, including:

- Health or safety regulations governing purchase, storage and/or use of specified items;
- Unallowable in accordance with government regulations;
- Available through Just In Time (JIT) vendors; and
- Subject to dye marking or other property-control procedures (such as tools).

In accordance with the policies and procedures, all cardholders (including buyers) are prohibited from procuring restricted items using a LANL purchase card. In specific instances, however, the Purchase Card Office granted exemptions to this policy. For example, cardholders who could demonstrate justification (such as lower price or faster delivery) were permitted to purchase JIT items using a purchase card. In another example, LANL granted exemptions to the tool policy providing the cardholders take personal responsibility for ensuring that all tools procured on a purchase card were dye marked. Other items, such as those that are unallowable in accordance with LANL and University of California policy, should not be procured using a purchase card. Examples of unallowable costs include awards, gift, memorabilia, advertising, entertainment costs and personal or luxury items that do not meet the test of business necessity.

Through our transaction testing, we found 264 purchases of items that appear to have been restricted for purchase on LANL purchase cards, totaling \$526,861. These restricted purchases were comprised of one or more of the following categories:

- Items which appear to be available on JIT (130 items totaling \$298,516);
- Possible unallowable expenditures (15 items totaling \$68,210);
- Items for which the business purpose was not clearly documented in the supporting documentation provided (53 items totaling \$68,673);²⁰ and
- Other purchases not authorized for procurement using a LANL purchase card (125 items totaling \$269,356).

b. Corrective Actions Taken

Our review indicated that many cardholders do not understand what can and cannot be procured using a purchase card. This problem is being addressed in mandatory refresher training for all cardholders. The fact that many restricted purchases were approved indicates that approvers are also unaware of LANL's policy regarding restricted items. The recent implementation of modified approver policies and related training should be effective in addressing this issue.

Finally, LANL is in the process of combining all lists of restricted items (JIT, unallowable, unauthorized and sensitive property) in a central location on the LANL intranet. A centralized list will make it easier for cardholders to determine if an item may be procured on a purchase card before the order is placed.

c. Recommendations for Further Corrective Action

In addition to the corrective actions implemented to date, we recommend that LANL consider updating the on-line Purchase Card System to include fields for purchase category and the business purpose. These additional fields will permit approvers as well

²⁰ We performed a preliminary analysis of items, which may have been for the personal use of the cardholder or requestor. Upon reviewing a sample of these items, we determined that most had reasonable business purposes.

as the Purchase Card Office to more effectively assess the appropriateness of purchase card purchases.

We recommend that the LANL Purchase Card Office perform routine data mining of purchase card transactions to identify possible purchases of restricted items. We provided the Purchase Card Administrator with a list of key words LANL can use to identify possible restricted items. Once identified, the Purchase Card Office should refer these transactions to the cardholder and approver for resolution. We recommend that the Purchase Card Administrator consider appropriate action to address cardholders who continue to procure restricted items after receiving appropriate warnings.

On November 21, 2002, we provided LANL management with a list of purchases aggregating \$766,722 that may have been unauthorized in accordance with LANL's policies and procedures. Such items were identified as a result of our data mining procedures. Management is currently researching these items to determine if the costs are appropriate, allowable and charged to the correct cost account.

6. Purchase Card Documentation and Support

a. Observation

LANL policies and procedures identify general categories of documentation that must be retained in support of purchase card transactions. Cardholders are required to complete an on-line PC Form noting descriptions of items purchased and the name of the requestor. In addition, they are also required to retain invoices, shipping documents, dispute forms and other relevant documents and are required to obtain special signatures when items are shipped off-site. We examined the documentation provided by cardholders in response to our sample requests to determine if cardholders are following these procedures in practice. We determined that descriptions, when provided, were generally accurate. In addition, we noted that cardholders often enter themselves as the requestor rather than the actual individual requesting the purchase. This practice allows for potential concealment of relationships between cardholders and requestors and also makes it difficult to locate the custodian of assets procured using a purchase card. We observed that items shipped off-site did not comply with the proof-of-delivery requirement.

b. Corrective Actions Taken

Our review of purchase card documentation indicated that some cardholders, particularly non-buyers, do not fully understand LANL's document retention requirements for purchase card transactions. This issue is being addressed in mandatory refresher training for all cardholders. Approvers are also being trained on documentation requirements so that they are able to assess the completeness of a cardholder's files.

LANL recently updated the shipping policy to require phone or Internet orders to be shipped to the LANL receiving facility. Orders are also required to include the

requestor's name and the word "PCARD" in the shipping address. The revised policy also prohibits purchase card orders from being shipped directly to the cardholder. Orders must now be shipped to a third party (the requestor, approver, another cardholder or co-worker). The revised policy does not prohibit cardholders from picking items up from the vendor.

In most recent revision of the policies and procedures, LANL changed the requirement for record retention when a cardholder transfers between divisions. Historically, cardholders were required to leave their documentation with the division they were employed by when the purchases were made. The revised policy requires cardholders to take documentation with them.

c. Recommendations for Further Corrective Action

We believe LANL's new policy prohibiting items from being shipped to the cardholder creates unnecessary opportunity for items to be misappropriated or lost. In lieu of this requirement, we recommend that whenever the cardholder and requestor are the same person, the cardholder should be required to document receipt by obtaining the signature of his or her approver on the invoice.

7. Sanctions for Non-Compliance

a. Observation

Cardholders and approvers must be held responsible for failure to comply with documented policies and procedures governing the Purchase Card Program. Historically, the policies and procedures have been silent on the issue of sanctions for non-compliance. As a result, the task of establishing and implementing appropriate sanctions was left to the discretion of the Purchase Card Administrator. This placed the Administrator in the difficult position of sanctioning cardholders without the ability to reference clear guidelines or rules. Furthermore, the current Purchase Card Administrator's authority to suspend or cancel cards is limited, making the implementation of effective sanctions impossible.

b. Corrective Actions Taken

The policies and procedures were recently updated to include warnings that failure to reconcile or approve within two statement cycles may result in suspension of the card.

c. Recommendations for Further Corrective Action

We believe the above changes to the policies and procedures regarding sanctions for failure to approve and/or reconcile are appropriate. In addition, we recommend that LANL establish firm guidelines for warnings and sanctions regarding non-compliance and include these guidelines in the policies and procedures and that the Purchase Card Administrator be given broader authority to implement sanctions in accordance with the established guidelines.

8. Training

a. Observation

Historically, cardholders received purchase card training when they first received a purchase card. Approvers have not historically been required to attend training. Refresher training was not required, although remedial instruction was occasionally provided when routine audits identified cardholders who were not in compliance. While interviewing cardholders, we determined that cardholders and approvers were unclear on some of the key policies and procedures. One experienced buyer was unaware that policies and procedures exist for the Purchase Card Program.

b. Corrective Actions Taken

LANL recently implemented mandatory refresher training for cardholders as well as mandatory training for approvers.

c. Recommendations for Further Corrective Action

We believe that the implementation of refresher training will be effective in improving overall compliance by cardholders and approvers. To underscore the importance of this training, we recommend that LANL establish a date by which all cardholders and approvers must complete this training. We further recommend that the Purchase Card Office take appropriate action with respect to individuals who fail to attend training by the established deadline.

We further recommend that LANL institute a requirement for periodic refresher training for cardholders and requestors. The Purchase Card Office should also continually update the training materials to ensure that all policy and procedure changes are addressed.

9. Purchase Card Office Audits and Reviews

a. Observation

A Purchase Card Office audit and review program, while not a substitute for compliance on the part of cardholders and approvers, is an effective means to maintain compliance with program policies and procedures. Historically, the Purchase Card Office conducted a number of audits and reviews designed to assess cardholder compliance. According to a former Purchase Card Administrator, the following procedures were routinely performed:

- Quarterly random audits;
- Monthly “desk review” of vendor names and descriptions for purpose of identifying unallowable, unauthorized or otherwise inappropriate transactions;
- Monthly or bi-monthly review of all items purchased for more than \$5,000. The intent of this review was to identify property-controlled items and to ensure that the items have been properly bar-coded; and

- Audits of new cardholders, conducted approximately three months after a new LANL purchase card was issued, in order to provide constructive feedback to the cardholder and to prevent improper practices from becoming habitual.

As staffing levels in the Purchase Card Office fluctuated over time, the audit and review program outlined above was altered. Only the random quarterly audit was consistently performed. According to the present Purchase Card Administrator, the office has been as much as one year behind on quarterly audits but is presently up-to-date.

b. Recommendations for Corrective Action

The audit and review program should not be the primary internal control. Rather, it should augment key controls including reconciliation, approval and training. To accomplish this goal, we recommend that the LANL Purchase Card Office expand its current audit program by adding new cardholder audits and routine data mining procedures. We also suggest that the Purchase Card Administrator meet at least annually with a representative from LANL's Audits and Assessments division to review audit procedures and findings. When appropriate, we recommend that LANL report findings to the cardholder and approver for appropriate correction and modification. We recommend that LANL perform routine data mining procedures to address the following areas:

- Failure to reconcile or approve;
- Split transactions;
- Possible purchases of unallowable or unauthorized items;
- New and/or unusual vendors;
- Possible purchases of property-controlled items; and
- Disputes not credited by the vendor or bank on a timely basis.

10. Management of Cardholder Spending Limits

a. Observation

New cardholders are granted an initial transaction limit of \$2,500 per transaction. Historically, the policies and procedures did not specify guidelines for maximum monthly credit limits, although \$25,000 was common for new cardholders. Sometime between 1999 and June 2002, language was added to the policies and procedures permitting a cardholder's limit to be increased once a cardholder has "established a sustained record of purchases". No ceiling was established for such limit increases.

We reviewed cardholder limits as of June 30, 2002 for 876 LANL cardholders. We found that 427 cardholders had single transaction limits of more than \$2,500; 141 cardholders had limits in excess of \$5,000; and 15 cardholders had limits of \$25,000 or more per transaction. Six cardholders (all buyers) had single-transaction limits of \$100,000 and two cardholders (buyers) had a monthly limit of \$900,000.

High transaction limits were not limited to buyers. Other cardholders were granted single transaction limits as high as \$25,000 and monthly credit limits up to \$500,000.

Despite the relatively high credit limits, we found evidence that some cardholders attempted to circumvent transaction limits by splitting purchases into two or more separate orders. The policies and procedures forbid cardholders from splitting transactions in order to avoid exceeding their maximum per transaction spending limits. In our transaction review, we identified 15 instances in which transactions appear to have been split.

Through our data mining efforts, we identified instances in which cardholders were permitted to spend beyond their single purchase or monthly credit limit. While, the bank administering the Purchase Card Program is responsible for denying purchases that exceed the cardholder's established limit, we not able to determine how the limits were allowed to be exceeded.

b. Corrective Actions Taken

Recent revisions to the policies and procedures instituted a maximum per transaction limit at \$5,000 and \$50,000 per month. Any increase to a higher limit must be justified in writing and approved by the approving official and division office.

c. Recommendations for Further Corrective Action

We believe LANL's recent actions to reduce cardholder spending limits are appropriate and increases to such limits should be made on a selective basis. In addition, we recommend that LANL perform regular data mining to identify possible split transactions and modifications to cardholder limits. Identified transactions should be referred to the cardholder and approver for resolution. The Purchase Card Office should take appropriate action when cardholders are determined to have split transactions

11. Safeguarding Card Information

a. Observation

Historically, cardholders have been instructed to safeguard purchase card information and to inform the bank immediately when a card has been lost or stolen. We assessed compliance with this policy by reviewing our transaction review sample. We identified at least two instances in which a cardholder appears to have shared his/her card number with a requestor or the requestor obtained the card number without the cardholder's knowledge. We also found instances in which other individuals in a cardholder's group used the purchase card without authorization.

b. Corrective Actions Taken

The revised policies and procedures clarify a cardholder's responsibility when a card is believed to have been compromised. In such instances, the new policy requires a cardholder to notify the bank, the approving official and the Purchase Card Office of the compromise within one day.

The most recent version of the policies and procedures includes a new clause, prohibiting cardholders from providing purchase card information to requestors.

Finally, mandatory refresher training for cardholders will function to remind cardholders about the importance of not sharing purchase card information with anyone. Approvers will also be reminded that purchase cards are the property of a cardholder, not the group, and cannot be used by anyone other than the cardholder.

c. Recommendations for Further Corrective Action

We believe the corrective actions implemented by LANL will be effective in addressing this control weakness. We have no further recommendations for corrective action.

B. Matters Referred to Appropriate Authorities

In conducting our review, the following transactions came to our attention and we understand they have been referred to appropriate authorities by LANL management.

1. Mustang Transaction

On May 1, 2002 a Mustang automobile was ordered and charged to a LANL purchase card. During May 2002, various charges from this vendor, totaling \$29,920, were posted to the cardholder's account. The cardholder disputed the charges and denied purchasing the automobile. Telephone records indicate a series of telephonic communications between the cardholder's office and the automobile vendor on May 1, 2002 and subsequent dates. As of this writing, the cardholder is on investigative leave from LANL.

2. Casino Cash Advances

Eleven cash withdrawals at three New Mexico casinos on a LANL purchase card were posted to between March 19, 2002 and April 26, 2002. The charges totaled \$1,417. A review of the cardholder's purchase card activity indicates that between March and May 2002, other questionable charges were posted to the purchase card account including charges from gas stations, a grocery store, LANL's cafeteria, and a discount retail store. The cardholder admitted making some of these charges but claimed they were for business purposes.

The cardholder was placed on investigative leave on August 19, 2002 and was subsequently terminated.

3. Retail Department Store Purchases

Data mining procedures identified two charges from a retail department store totaling \$1,045 posted to a LANL purchase card account on February 21, 1999 and April 16, 1999. We interviewed the cardholder with respect to these transactions. Initially, the cardholder admitted making the charges. When the charges appear to have been disputed, the the cardholder provided a different explanation, stating the charges were fraudulent and that dispute procedures had been initiated with the bank. No credit was ever issued by the bank nor was the cardholder able to provide evidence that the charges were in fact disputed.

We also requested supporting documentation for a charge posted to a LANL purchase card by a retail department store on June 11, 2000 in the amount of \$232. The cardholder reconciled the statement, which was subsequently approved. When the External Review Team requested supporting documentation for the transaction, the cardholder stated that the LANL card was erroneously used in place of a personal credit card and the vendor had reversed the charge. The cardholder was not able to provide supporting documentation nor was evidence of the charge reversal identified.

4. Jewelry

Our data mining procedures identified three transactions, which appear to be purchases of jewelry. On September 22, 1998 and November 17, 1998, two charges identified as cubic zirconium jewelry were posted to a LANL purchase card. The charges totaled approximately \$80. The cardholder denied making the charges to the approving official. The cardholder states that several unsuccessful attempts were made to dispute the charges with the vendor. We found no evidence that the charges were disputed with the bank and the charges were never credited or reversed by the vendor or the bank.

On July 22, 1999, another LANL cardholder made a purchase from a jewelry store in the amount of \$158.87. On September 9, 1999 the cardholder reimbursed LANL for the purchase, stating that she had inadvertently used her LANL card to make a personal purchase. As the cardholder reimbursed LANL shortly after receipt of the statement, this transaction was not referred to authorities.

IV. Limitation of Procedures Performed and Resultant Findings

The observations and findings outlined in this letter are based on the procedures performed through November 8, 2002. During the process of performing our work, we were not able to independently verify all events. At the request of LANL management and as coordinated with law enforcement authorities, we did not interview several LANL employees or individuals outside of LANL, whose insights may have been relevant to our findings. Finally, our procedures were designed to fulfill the tasks outlined above in Section I and were not specifically designed to detect fraud. We do not make any representation as to the adequacy or sufficiency of our procedures for LANL's purposes.